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van Dalen, Hendrik Peter; Henkens, C.J.I.M.

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Commentary

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The COVID-19 Pandemic: Lessons for Financially Fragile and Aging Societies

Hendrik P. van Dalen[1,2] and Kène Henkens[1,3,4]

1. Netherlands Interdisciplinary Demographic Institute (NIDI-KNAW), P.O. Box 11650, NL-2502 AR The Hague, The Netherlands
2. Tilburg School of Economics and Management (TISEM), Tilburg University, P.O. Box 90153, NL-5000 LE Tilburg, The Netherlands
3. University Medical Center Groningen (UMCG), University of Groningen, P.O. Box 72, NL-9700 AB Groningen, The Netherlands
4. Department of Sociology, University of Amsterdam, Oudezijds Achterburgwal 185,1012 DK Amsterdam, The Netherlands

ABSTRACT

The current COVID-19 crisis teaches organizations and households harsh lessons about the necessity of having buffers, to deal with the consequences of the COVID-19 virus. The financial fragility of households and the rising proportion of people becoming obese calls for intensified efforts, both by individuals and employers to create financial buffers and keep on investing in health. The financial fragility of organizations is a wake-up call that a short-term focus on efficiency can be counterproductive and may overturn the efforts to start working longer.

"The market will test you and do what you don't expect it to do." This practical warning was uttered by Leo Melamed—former chairman of the Chicago Mercantile Exchange—when in 1997, the Asian financial crisis erupted. The same warning might be applied today when thinking about the economic and societal consequences of the COVID-19 crisis that has caught the world by surprise. It is perhaps too early to see the full ramifications of how the COVID-19 virus will impact our lives. However, this extremely large shock to the system has the unintended benefit that drives people to take a different look at what was common practice just a few months ago.

When we consider the management of organizations, work, retirement, and pensions, an overarching theme is becoming clear. We have become so "lean and mean" in organizing societies that a lockdown of the economy reveals a very simple truth: we lack the buffers to weather a storm. In banking circles, banks are regularly checked by regulators on their ability to survive a crisis by using stress tests. However, compared to the financial crisis of 2008, the COVID-19 crisis is stress test of an entirely different character, one that is beyond anyone's imagination, and that applies to every citizen and organization. The lack of financial buffers, or more prosaically "firewalls," is an issue that plays out at every level in society. Workers and pensioners often lack the buffers to survive a financial setback, and organizations, and certainly the self-employed, also lack the buffers to finance a temporary "lockdown."

A lack of these buffers has, of course, always been part of our societies. A large portion of the population are financially illiterate, may be overconfident, have invested highly in illiquid assets (e.g., houses) financed by debt (Kaplan, Violante, & Weidner, 2014), or simply lack the financial resources to create a buffer (Lusardi & Mitchell, 2014; Lusardi, Schneider, & Tufano, 2011). The modern welfare state is, in principle, a safety net for these people, but a number of developments have made this situation worse over time.

SOCIETIES CAN BECOME "TOO EFFICIENT"

One reason that societies have become more vulnerable to crises is their failure to recognize what John Maynard Keynes (1937) called "irreducible uncertainty": uncertainty that cannot be reduced to statistical probabilities. We simply do not know what is going to happen in, say, 10- or 20-years' time. Put differently, there will always be "unknown unknowns." This is important because, in everyday life, banks, insurance companies, and pension funds make decisions as if they do know the relevant risks, but this convention will only hold in less turbulent times. As soon as a society is in a state of flux—when a war erupts, a state or a city is flooded, or a pandemic spreads—anything can happen, and the rules and conventions are no longer of use. For those who think that every risk can be calculated, crises always seem unexpected. It is the price of becoming complacent: the tacit belief that the world will always be the same. Pension funds and insurance companies can make calculations up to 50- or 100-years' time, but these calculations are based on the premise that the structure of society or population stays the same or seems to be predictable. However, what often was optimal in the old world is no longer sustainable in the new post-crisis era. The government, as a provider of public pensions, is

Correspondence concerning this article should be addressed to Hendrik P. van Dalen. Tilburg School of Economics and Management (TISEM), Tilburg University, P.O. Box 90153, NL-5000 LE Tilburg, The Netherlands E-mail: h.p.vandalen@uvt.nl
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essentially the only player that can invoke the solidarity between generations (Gordon & Varian, 1988). Governments can spread risks across decades that would otherwise have to borne by a small set of generations (or in theory, eternity).

… AND ORGANIZATIONS TOO

If one goes back in time, organizations have undergone a metamorphosis. Simply put, in striving for efficiency, organizations often tried to rid themselves of functions, tasks, and departments that were not considered "core business." The focus on the short-run has been amplified by capital market participants in search for a high rate of return (Rappaport, 2005). The adverse consequences of this stance were quite apparent during the Great Recession (Admati & Hellwig, 2014). To achieve even more efficiency, organizations cut inventories and make production run "just-in-time." A car manufacturer does not need an entire storage building with nuts and bolts; it can streamline the logistics. As long as every part of the supply chain functions smoothly, things are fine. The darker side of this development is that once a pandemic hits the world economy, the efficiency of a global market breaks down, and supply chains dysfunction. In short, the paradoxical lesson of not accounting for uncertain events: organizations can become too efficient.

This short-term focus is also visible in contractual labor relations in current labor markets. Employment contracts are increasingly temporary and insecure (Eichhorst, Marx, & Wehner, 2017). A basic reason and defense for turning to such "nonstandard employment relations" is the constant striving for innovation and growth. Innovation is a risky business. The burden of having a large work staff covered by strict employment protection laws is for many employers an incentive to aim for safe and small innovations and not for high-gain and risky innovations (Bartelsman, Gautier, & Wind, 2016). Thus, the drive towards lower employment protections becomes an understandable move in some countries, but it has led to practices that increase the division between insiders and outsiders (Lindbeck & Snower, 2001). Insiders are those who have steady jobs and are well protected, and outsiders are those who are more vulnerable to atypical work and unemployment (e.g., lower educated young workers, unemployed older workers, and immigrants) for whom short-term contracts are the dominant option (Biegert, 2019; Eichhorst et al., 2017).

BUILDING BUFFERS IN COVID-19 TIMES

The big question is, of course, how can organizations and people turn this state of affairs around and focus on the current crisis: what should be a proper response if the development of vaccine takes longer than expected and the COVID-19 crisis remains a part of everyday life? The key "asset" for societies is to acknowledge the importance of buffers at all levels in society. Two types of buffers or "firewalls" strike us as particularly important in aging societies, although each has its own set of unresolved questions and calls for future research.

Household Buffers

It is well acknowledged that the need for buffers is paramount in today's world as pensioners and workers are in for hard times when they do not have a financial buffer. It is well established in the literature how pervasive financial fragility is among households in the United States (Hasler, Lusardi, & Oggero, 2018; Lusardi, 2019; Munnell, Sanzenbacher, & Walters, 2020) and in Europe (Ampudia, van Vlokhoven, & Żochowski, 2016). This makes these households very vulnerable to unexpected financial setbacks, like a car repair or a trip to hospital, let alone events like becoming unemployed, or in case they are retired a cut in their pension benefits. A survey in 2015 among U.S. households shows that 60% of the households experienced an unexpected financial shock, and 50% of those households had difficulty making ends meet after the financial shock. Predictably, this difficulty in recovering was particularly visible among low-income households and the younger generations (Pew Research, 2015).

Inadequate pension savings among workers is a structural element of working life in most developed countries (OECD, 2014). For instance, Munnell, Hou, and Sanzenbacher (2019) show that the percentage of U.S. households at risk of having insufficient pension savings hovers around 50%. Another recent study by Gomes, Hoyem, Hu, and Ravina (2018) focused only on U.S. households with defined contribution plans concludes that 75% are at risk of having saved too little. To correct this state of affairs, societies can resort to different measures such as the long-term route of investing in financial literacy (Kaiser & Menkhoff, 2017), but they can also take a more direct approach, such as by making supplementary pension savings by employers mandatory, or by nudging and informing workers in the direction of making their households more financially stable (Clark, Morrill, & Allen, 2012).

However, for households, it is also important to invest in their human capital and their health, which is essentially a form of human capital (Becker, 2007; Grossman, 1972). Structural economic reforms are needed to enhance households' financial ability to invest in human capital over the length of their career. Spending on medical care and advice, as well as the development of lifestyles, can be just as productive as the development of skills, education, or on-the-job training. Investing in human capital is not only essential to being productive over the life course, but is also essential to working in good health and enjoying retirement in good health. It has been clear that people who are obese and who also face complications such as diabetes and hypertension are more likely to become seriously ill and have a higher mortality risk if they are infected with the COVID-19 virus (Finer, Garnett, & Bruun, 2020; Williamson et al., 2020). Before the crisis, the need for corrective measures for the spread of obesity was already clear. Obesity itself is almost a pandemic-like phenomenon (Vidra, Trias-Llimós, & Janssen, 2019; Zhang, Saito, & Crimmins, 2019) with strong implications for the quality of later life. Given that the prevalence rate of obesity among U.S. adults in 2017–2018 is 42.4% and 9.2% is considered severely obese (Hales, Carroll, Fryar, & Ogden, 2020), reducing obesity should be a top priority. Although tackling obesity is complex, the role of the household in providing support and developing healthy lifestyles (e.g., diet choices, exercise) is important, and investments in "human capital" could not only save lives in the face of a pandemic, but also lessen the burden on the health care system (OECD, 2019).

Although a large part of this responsibility lies with the individual, employers should also bear part of the responsibility and play an active role in health promotion by means of workplace design. According to Goh, Pfeffer, and Zenios (2016), 5% to 8% of U.S. annual health care costs "are associated with and may be attributable to the way U.S. companies manage their work forces." (p. 608) A similar conclusion is drawn by Gonzalez-Mulé and Cockburn (2017), who show that employees working in high demand and low control jobs (e.g., those in frontline service and manufacturing) "carry above-average risks of mortality resulting, with accompanying large personal and societal costs." (p. 97). Much of this excessive health expenditure in the United States can be prevented, according to Goh, Pfeffer, and Zenios (2019), by extending health care insurance and reducing exposure to workplace stressors.

Organizational Buffers

The concept of buffers also applies to firms that, over time, have become financially fragile in the search for efficiency. Besides the importance of financial buffers, the COVID-19 crisis draws attention to three types of buffers that have become particularly relevant for an aging workforce.

The first is to create more flexibility in the working environment. Flexibility in terms of work schedule and work location are generally seen as being beneficial work features that may promote continued employment of older workers (Dropkin, Moline, Kim, & Gold, 2016). High levels of flexibility with respect to schedule and location are strongly associated with higher levels of work satisfaction among older workers (Damman & Henkens, 2018). The recent "lockdown" of many economies has been a catalyst for this "strategy by necessity." It has been put into practice by numerous organizations, by letting employees work from home, and offering products and services online. In the short-run, this has proven to be a lifesaver for employees and organizations who were able to do so. However, whether "going online" and working from home are good long-term approaches have yet to be proven over time. Prolonged working from home without any physical encounters with colleagues may have adverse consequences for workers (e.g., reduced well-being, performance, and organizational commitment) and organizations (e.g., reduced productivity and corporate identity).

Organizations that have no or limited opportunities for providing flexible work environments are challenged to organize their activities around taking the restrictions of social distancing into account. Performing your tasks in an environment where you have to remain at least 6 feet apart from your coworkers and clients at all times will be demanding for every employee. Older workers might be particularly worried and anxious because the risks associated with COVID-19 infections are more severe at advanced ages (Ferguson et al., 2020). For example, older workers who work in so-called "essential jobs," where social distancing is not possible, will need to take many additional precautions. Protecting older workers in such environments may, therefore, imply costly measures that, in turn, reduce employers' propensity to hire or retain those workers. In other words, for older workers, the COVID-19 virus may not only be a health risk, but also a labor market risk. Hence the prospect of working longer will become more difficult to realize despite the willingness of employers and employees over the recent years (Clark & Ritter, 2020; Turek, Oude Mulders, & Henkens, 2020).

CONCLUSION

The saying "Never let a good crisis go to waste" is often heard. The COVID-19 crisis may indeed be a crisis that should not be wasted as it offers an opportunity to discover new truths and rediscover old truths. The search for buffers—either financial or in kind—will be an essential part of dealing with a crisis like COVID-19. And one might add, this is even more the case than during a financial crisis like the one we experienced in 2008. The importance of a solid welfare state as well as firms and households that build up reserves to prevent a liquidity crisis was at that point a clear message. "Cash is king" is the standard expression among bankers in times of crisis. But what the current crisis shows is that capital—financial *and* human—is probably the most desirable asset to have.

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